

MOODY'S

INVESTORS SERVICE

Rating Update: Moody's upgrades to Aa3 from A1 the rating on Bay County's (MI) GOLT debt

Global Credit Research - 01 Mar 2013

Upgrade affects \$1.43 million of rated GOLT debt

BAY (COUNTY OF) MI
Counties
MI

Opinion

NEW YORK, March 01, 2013 –Moody's Investors Service has upgraded to Aa3 from A1 the rating on Bay County's (MI) general obligation limited tax debt. The county has \$23.8 million of general obligation limited tax debt outstanding, of which \$1.43 million is rated by Moody's.

SUMMARY RATINGS RATIONALE

The county's general obligation limited tax debt is secured by its limited tax pledge payable from all taxable property subject to constitutional and statutory levy limitations. The upgrade to Aa3 reflects the county's sound financial operations supported by steady growth in reserve levels and the presence of additional alternative liquidity, sizable tax base that has experienced modest declines in valuation, below average wealth indices, and a low debt burden with rapid principal amortization. The Aa3 limited tax rating is one notch below an implied Aa2 general obligation unlimited tax rating. Debt service on general obligation limited tax bonds are payable by operating funds of the county, which are subject to levy limits.

STRENGTHS

- Strong reserves in the General Fund and Delinquent Tax Fund
- Conservative financial management which has driven stable financial operations

CHALLENGES

- Small declines in valuation
- Limited operating flexibility
- Below average wealth levels

DETAILED CREDIT DISCUSSION

SIZABLE TAX BASE WITH BELOW AVERAGE RESIDENT INCOME PROFILE

Bay County is located on the eastern side of Michigan's lower peninsula forming the southern and western boundaries of Saginaw Bay on Lake Huron, approximately 100 miles northwest of the City of Detroit (general obligation rated Caa1/negative). The county's \$6.2 billion full valuation tax base has experienced valuation declines for the past four years, but at a more moderate rate than similar local governments in the state of Michigan (general obligation rated Aa2/stable) with declines of 1.2% and 0.9% in 2011 and 2012, respectively. Despite increases in agricultural land and personal property taxable valuations, officials anticipate another slight decline for 2013 as valuations begin to stabilize.

The county benefits from relatively diverse employment opportunities with notable employers including SC Johnson, Dow Corning, and General Motors (long term rating of Ba1/positive outlook). The largest employer in the county is Bay Regional Medical Center, a for-profit hospital, that employs approximately 1,773 people. Officials note stability amongst area employers with no major layoffs or developments pending. Despite recent layoffs at facilities in neighboring Midland County (general obligation limited tax rated Aa3), Dow Corning, Bay County's second largest tax payer and employer, specializes in silicon and silicon-based technologies and is reported to

have leased 100,000 sq. feet of office space starting in 2014 at the Uptown Bay City development in Bay City (general obligation rated A1). The county's largest tax payer, Consumer Energy, accounts for 8.9% of the county's total assessed valuation with the utility's largest of seven power plants located on Saginaw Bay. Overall, the top ten largest taxpayers are somewhat concentrated at 16.2% of the county's total assessed valuation.

At 6.9% in October 2012, the unemployment rate in Bay County was below both state and national rates of 8.3% and 7.5%, respectively. The county's income levels have weakened compared to national averages over the past decade with median family income estimated at 85.5% of the nation in 2010, down from 96.1% in 2000. The county has also realized a steady decline in population over the past three decades, including a modest 2.2% decline between 2000 and 2010 census periods to its current population of 107,110.

MANAGEMENT MAINTAINS STRONG FINANCIAL OPERATIONS SUPPORTED BY SIZABLE RESERVES

We expect the county's strong financial position to continue, supported by sizable reserves and prudent financial management. The county has seen a steady increase in General Fund reserves since fiscal 2003 where total General Fund reserves totaled \$3.86 million, or 13.9% of revenues. In fiscal 2011, General Fund reserves were strong with total fund balance totaling \$11.31 million, or 35.7% of revenues. The increase in fund balance over the past decade can be attributed to management's aggressive expenditure reductions and budgetary practices. The county also maintains significant alternate liquidity in its 100% Tax Payment Fund. The fund is utilized for the purchase of delinquent taxes of underlying local governments, with the county collecting fees and interest expense on the taxes that are subsequently received. In fiscal 2011, the fund's unrestricted net assets totaled \$7.46 million. Combined with the General Fund, the unrestricted net asset position of the tax payment fund results in total available fund balance for the county of a strong \$18.77 million, or 59.2% of revenues. Management estimates that General Fund reserves increased by roughly \$500,000 in fiscal 2012. A balanced budget has been adopted for fiscal 2013, though management expects General Fund balance could increase further.

Property taxes are the primary revenue source for the county comprising 51.7% of fiscal 2011 revenues. Annual property tax receipts have decreased approximately \$1 million since fiscal 2009 given recent declines in valuation; however, management has offset these revenue declines with expenditure reductions and reduced general fund transfers. The county is currently levying at its millage limit of 5.73 mills for operating which takes into effect the Headlee Rollback legislation which essentially "rolls back" the levy rate when property values outpace inflation. Officials note that a vote from the electorate could overturn the rollback to allow the county to levy the 6.0 mills originally authorized. The county's second largest revenue source is from state grants comprising 12.6% of fiscal 2011 revenues.

AVERAGE DEBT BURDEN WITH RAPID PRINCIPAL AMORTIZATION

We expect the county's debt burden to remain manageable given a rapid rate of principal amortization. The county's overall debt burden is average at 3.2% of the tax base while its direct debt burden is minimal at 0.2%. Principal amortization is rapid with 100% of principal retired within ten years. Approximately 35% of the county's debt has been backed out and is not included in the debt burden coverage. This debt has been issued on behalf of underlying local governments and is expected to be repaid by those municipalities in accordance with contractual agreements. While secured by the county's general obligation limited tax pledge, these bonds are general obligations of the benefiting municipalities and payable from either utility user fees or special assessments levied within those municipalities. Inclusive of debt that has been backed out, the county's direct debt burden is a modest 0.4% of full valuation. To date, there have been no reported issues of an inability to pay debt service within the underlying local governments and the county has not been required to offer General Fund support.

The county expects to issue approximately \$60 million of general obligation limited tax bonds over the next three years to finance construction of a new water plant, with the first installment of \$12 million coming in September 2013. Officials note that the plant will provide service to 15 local municipalities each of which will collect user fees from residents to meet debt service payments. The county received a \$12 million loan from the state's Drinking Water Revolving Fund for the project of which a portion may qualify for principal forgiveness. All of the county's debt is fixed rate and there is no exposure to interest rate swap agreements.

WHAT COULD CHANGE THE RATING UP

- Substantial expansion and diversification of the county's tax base
- Strengthening of the county's demographic profile

WHAT COULD CHANGE THE RATING DOWN

- Erosion of the county's tax base and demographic profile below similarly rated entities
- Significant reductions in reserves and liquidity levels in the General Fund and/or other funds

KEY STATISTICS

2010 Census population: 107,771 (2.2% decrease since 2000)

2012 full valuation: \$6.24 billion (2.1% average annual decline since 2007)

Per capita income (2006-2010 American Community Survey estimates): \$23,049 (91.7% of MI, 84.3% of US)

Median family income (2006-2010 American Community Survey estimates): \$53,824 (89.2% of MI; 85.5% of US)

County unemployment (October 2012): 6.9%

Direct debt: .2%

Overall debt: 3.2%

Principal payout (10 Years): 100%

Fiscal 2011 General Fund balance: \$11.31 million (35.7% of revenues)

Fiscal 2011 100% Tax Payment Fund unrestricted net assets: \$7.46 million

PRINCIPAL METHODOLOGY USED

The principal methodology used in this rating was General Obligation Bonds Issued by U.S. Local Governments published in October 2009. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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